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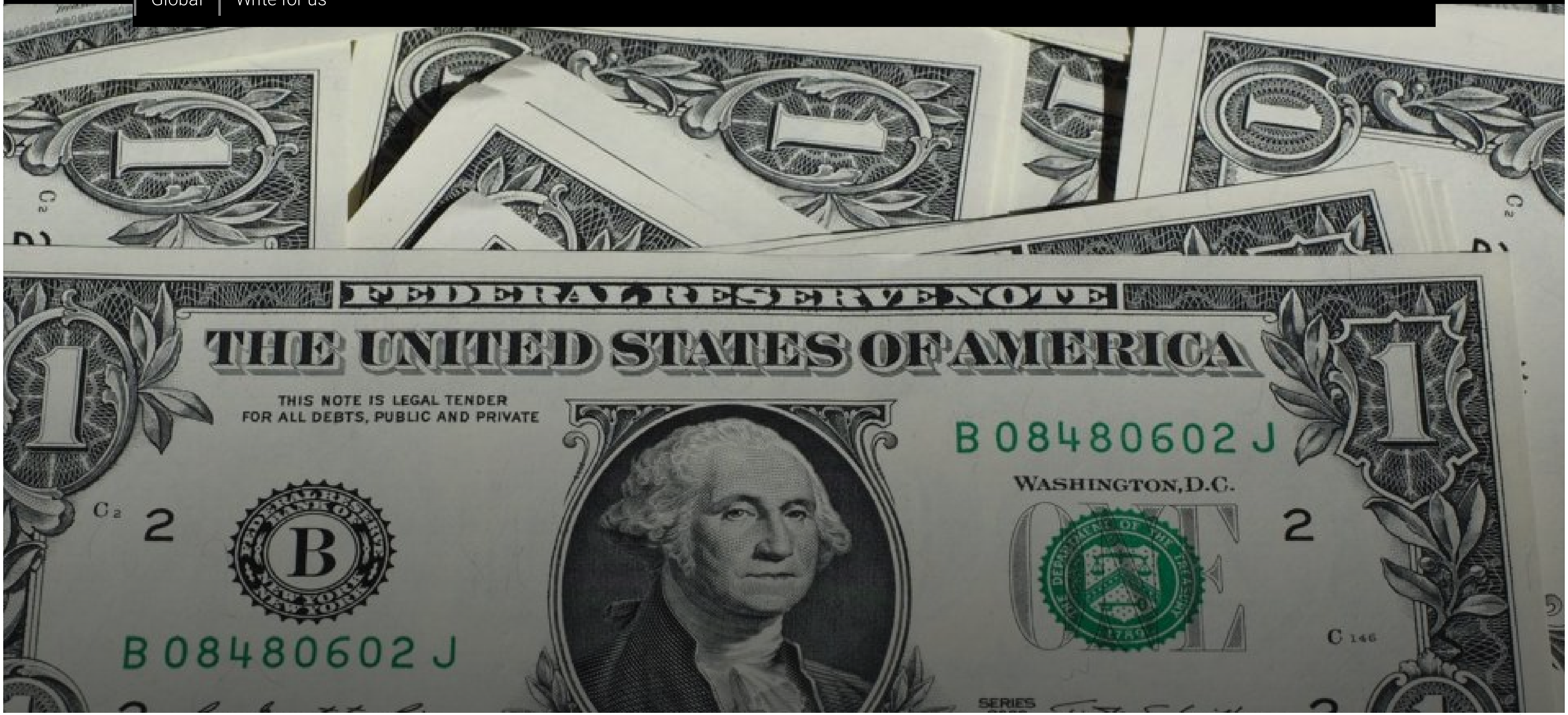

US and Canada

TOWARDS A ‘DE-DOLLARIZED’ GLOBAL OIL MARKET?

Luciano Magaldi / 02/07/2022 / 0

The U.S. dollar has been the unquestioned reserve currency worldwide since the 1970s. Agreements with Saudi Arabia and numerous other Middle Eastern nations solidified the global oil market’s use of the U.S. dollar. Trading of dollars for oil and gas marked a departure from the conventional ‘gold standard’ and cemented the United States’ dominance as the world’s dominant trading nation. Even if the Euro emerged as a serious challenger in the 1990s, dollar-denominated finance continued to thrive. Nations like China and Russia were forced to hold U.S. Treasury bonds and build up significant dollar reserves. However, a number of geopolitical and economic variables are currently working against the U.S. dollar’s hegemony. For the dollar, rapid globalization was already a ticking time bomb. But now, this historic change is being sped up by China’s emergence as the next major player and Russia’s exclusion from the SWIFT system, which is denominated in dollars.

De-dollarization is a tendency that has been around for a while. The controversial trend away from using U.S. dollars was first sparked in Latin America in the 1990s. Venezuela tried to break with the established quo in reaction to the United States’ sanctions by choosing to pay for its oil in yuan rather than dollars. To compete with U.S. Treasuries on the secondary market, Chile used Consumer Price Index (CPI) indexation to entice foreign capital into domestic assets. The tendency of de-dollarization, however, sharply reversed after the 2008 financial crisis as a result of inadequate supplemental monetary policies and debilitating economic difficulties. Since that time, no noteworthy event has threatened to undermine the U.S. dollar’s hegemony. The next terrible omen, though, might be the growing Asian markets and the undercurrent of discord between the United States and Saudi Arabia.

Saudi Arabia exports the most crude oil in the world, accounting for around 17.2% of all exports (by value). Saudi Arabia has served as one of the United States' most important Middle Eastern allies for many years. In terms of trade, the monarchy has been the biggest provider of crude oil to the United States. Additionally, the United States has had influence on global oil prices due to Saudi Arabia's leadership of the Organization of Petroleum Exporting Countries (OPEC). Since the oil trade is conducted in U.S. dollars, successive Washington governments have been able to run enormous trade deficits without worrying about their budgets. Throughout orders to confront its arch-rival Iran, the Saudi kingdom has served as a geopolitical proxy for the United States in the Middle East. Following the historic Iranian revolution of 1979, Saudi Arabia moved up the list of preferred American allies in the area. The two friends have, however, begun to drift apart somewhat as the political balance has shifted from Republicans to Democrats.

Through the development of its own strategic reserves, the United States has gradually reduced its reliance on foreign oil. For instance, in the 1990s, the United States imported almost 2 million barrels of Saudi crude every day. That figure fell to mere 500,000 barrels per day in 2021 – a drop of 75% in a couple of decades. The Saudi royal family has expressed particular dissatisfaction with Biden's Middle East policies on the political front. Saudi Arabia was cut off from the Washington government by Biden's decision to unilaterally end Saudi Arabia's backing for the conflict in Yemen. Houthi attacks on Saudi oil facilities in a subsequent wave have further enraged the kingdom. Biden's desperate attempt to save the outmoded 'Nuclear Deal' with Iran has essentially alienated the kingdom to the point of apathy, which only serves to fuel the flames.

The implications have been obvious. Since Russia began attacking Ukraine in February, Saudi Arabia has deliberately disregarded calls from President Biden to increase crude supply quotas and down global oil prices. The 'OPEC+ alliance', which consists of OPEC members as well as Russia and other allies, kept to its original commitment to expand output by just 432,000 barrels per day in June. Other than the ongoing dispute with the United States, there is another reason for the callous disregard for the Western calls. The rising Sino-Saudi cooperation is the cause. Saudi Arabia's role in the global oil trade has changed significantly during the last several years. That is mostly attributable to China's expanding collaboration, which is not just in the energy industry. Through bilateral cooperation in infrastructure, trade, and investment, China has objectively increased the potential reach of its 'Belt and Road Initiative (BRI)' throughout the kingdom.

The cumulative value of Chinese investments in Saudi Arabia, according to the American Enterprise Institute's China Global Investment Tracker, was $43.47 billion in 2021. Over 25% of the country's total global oil exports were made up of the anticipated 542.39 million tons of crude oil that China imported in 2020, according to statistics made public by the Chinese General Administration of Customs (GACC) . After years of restricting its abroad interests to the U.S. and Europe, sources from Saudi Arabia's top securities regulator indicate that the country's sovereign wealth fund may soon begin investing in Chinese enterprises. Official sources claim that the Chinese petrochemical consortium and the Saudi oil behemoth Aramco are in collaboration negotiations. Aramco just completed a $10 billion transaction with Chinese oil companies. All the evidence conclusively shows that Saudi Arabia is shifting its allegiance from the U.S. to China. De-dollarization of commerce and investments will undoubtedly improve bilateral ties with China.

When compared to its equivalent, the petroyuan does have several disadvantages. Despite the exponential growth of China's financial markets over the past few decades, they still lack the U.S. capital markets' level of liquidity. Furthermore, commerce in European markets is greatly facilitated by the enormous U.S. $13.4 trillion eurodollar market. The People's Bank of China would be able to manipulate yuan trades, which would be restricted to China. Thus, the smooth operation of trade and short-term savings will be hampered by transactions settled in yuan. However, if petroyuan is utilized as a barter for investments in China, these issues might be remedied.

Russia and Iran's economies have moved closer to Asia than Saudi Arabia's as well. For instance, Russia has frequently stated its preference to trade its oil in Asia while subject to Western sanctions via the Cross-Border Interbank Payment System (CIPS), a system for clearing international settlements and commerce in the Renminbi. Since the invasion of Ukraine, India has publicly resisted U.S. pressure by acquiring around 15 million barrels of oil from Russia. Currently, nearly 17% of Indian imports are made up of Russian crude, compared to less than 1% prior to the invasion. The most basic explanation is that oil costs less in roubles, especially since Europe is still considering an oil embargo on Russia. Even Iran has been known to trade crude oil with China while subject to U.S. sanctions by giving up the currency.

Even if the effects of de-dollarization were compounded, some economists may contend that they would be sluggish and unprofitable. However, we must recognize that the historical backdrop is skewed and that current ground realities are very different. First off, compared to the growing

economies of Latin America addressed in the IMF literature, the economies in Asia are substantially less dollarized. Second, in terms of size and monetary policy, the Asian economies—in particular, China and India—are far more relevant. Even a move toward semi-dollarization might undermine U.S. influence and greatly weaken the effectiveness of U.S. sanctions.

Understandably irritated by the OPEC+ alliance's disobedience is the U.S. Congress. Recently, the No Oil Producing or Exporting Cartels (NOPEC) measure to modify U.S. antitrust law was approved by the Senate Judiciary Committee. If approved by the whole Senate and House, the U.S. Attorney General would be given the power to sue OPEC+ countries for alleged cooperation, circumventing the sovereign protection that OPEC+ countries are guaranteed. Although similar motions have been made and rejected over the past 20 years, the U.S.'s desperation in the face of powerlessness stands out. In 2019, Saudi Arabia forewarned U.S. legislators that if the plan was passed, it would require it to trade oil in multiple currencies. Today, it appears like the inevitable shift away from the U.S. dollar may occur sooner than previously anticipated, given Europe's tardy time-frame to phase out Russian crude and China's growing clout in Eurasia.

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